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In the Supreme Court of the United States

OCTOBER TERM, 1975

BIEDENHARN REALTY COMPANY, INC., PETITIONER

v.

UNITED STATES OF AMERICA

*ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS FOR
THE FIFTH CIRCUIT*

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

ROBERT H. BORK,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

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The sole question presented in this federal income tax case is whether petitioner's gains from the sale of subdivided and improved real property were taxable as ordinary income, as the decision below held, or as capital gains.

The pertinent facts are as follows: In 1935, petitioner acquired Hardtimes Plantation (consisting of 973 acres) as an investment for \$50,000. Petitioner farmed the land for several years, and subsequently leased the land to a farmer who is presently farming portions of the Plantation. From 1935 to 1966 petitioner carved out 185 acres in three separate subdivisions from the Hardtimes Plantation and sold 208 subdivided lots in 158 sales at a total profit of more than \$800,000 (Pet. App. A4-A6). Prior to 1966, petitioner also sold other parcels of real estate. From its inception in 1923 un-

til 1966, petitioner sold 934 lots of non-Hardtimes Plantation realty. Prior to its acquisition of the Plantation, petitioner sold 249 lots during the period 1923-1935. After its acquisition of the Hardtimes Plantation in 1935, petitioner sold 477 non-Hardtimes lots from 1935-1966 (Pet. App. A7).

Petitioner's sales of Hardtimes lots began in 1939 with the opening of its first subdivision. Petitioner opened a second subdivision in 1951, and resubdivided it in 1964. From that second subdivision, petitioner sold 73 lots during the period 1951-1966 (Pet. App. A6). Petitioner opened a third subdivision in 1955, which it resubdivided in 1960. From 1955-1966, petitioner sold 104 lots from the third subdivision (Pet. App. A6). Prior to its sale of lots from these Hardtimes Plantation subdivisions, petitioner improved the land by installing streets, drainage, water, sewerage, and electricity at a total cost for the three subdivisions in excess of \$200,000 (Pet. App. A11). Petitioner sold the lots through local real estate brokers, but petitioner set the prices and credit terms and signed the deeds (Pet. App. A13).

On audit, the Commissioner of Internal Revenue determined that petitioner's sales of lots during the period 1964-1966 were sales of "property held *** primarily for sale to customers in the ordinary course of [a] trade or business" and that the profit on the sales was taxable as ordinary income and not as capital gains. In this refund suit, the district court upheld petitioner's position that its gains from the sales of lots were taxable as capital gains (Pet. App. A65-A78) and a divided panel of the court of appeals affirmed (Pet. App. A53-A64). On the government's petition for rehearing with suggestion of rehearing *en banc*, the full court of appeals held (8-5) that the gains from petitioner's real estate sales were taxable as ordinary income (Pet. App. A1-A52).

1. Section 1221(1) of the Internal Revenue Code of 1954 (26 U.S.C.) excludes from the definition of capital asset "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." In its prior decision in *United States v. Winthrop*, 417 F.2d 905, 910 (C.A. 5), the court of appeals enumerated the following factors in making a determination under the statute: (1) the nature and purpose of the acquisition of the property and the duration of the ownership; (2) the extent and nature of the taxpayer's efforts to sell the property; (3) the number, extent, continuity and substantiality of the sales; (4) the extent of subdividing, developing, and advertising to increase sales; (5) the use of a business office for the sale of the property; (6) the character and degree of supervision or control exercised by the taxpayer over any representative selling the property; and (7) the time and effort the taxpayer habitually devoted to the sales.

Here, after a careful examination of the record in the light of the *Winthrop* factors, the court of appeals correctly concluded that petitioner's "real property sales activities compel an ordinary income conclusion" (Pet. App. A19; footnote omitted). The court based its holding on its factual analysis of the frequency and substantiality of petitioner's sales carried on by brokers and the improvements it made to the property.

Petitioner contends (Pet. 7) that the fact that it acquired the property in question as an investment should be determinative that its gains from the sale of the lots were taxable as capital gains. But no court has ever held that the taxpayer's original investment motive in

purchasing real property automatically precludes ordinary income treatment upon its sale.¹ Here, the court of appeals applied the well established rule that the holding purpose of property may change (Pet. App. A37, A40, and A42) and that it is the purpose for which the property was being held at the time it is offered for sale which is controlling. *Nadalin v. United States*, 364 F.2d 431 (Ct. Cl.); *Continental Can Corp. v. United States*, 422 F.2d 405 (Ct. Cl.); *Commissioner v. Tri-S Corp.*, 400 F.2d 862 (C.A. 10); *Ackerman v. United States*, 335 F.2d 521 (C.A. 5); *Pool v. Commissioner*, 251 F.2d 233 (C.A. 9); *Bauschard v. Commissioner*, 279 F.2d 115 (C.A. 6); *Bynum v. Commissioner*, 46 T.C. 295. Indeed, petitioner acknowledges (Pet. 11) that "every circuit" has adopted the factor-by-factor analysis employed by the court of appeals in this case.

Petitioner challenges (Pet. 8-9) the court of appeals' statement that "[t]here will be instances where an initial investment purpose endures in controlling fashion notwithstanding continuing sales activity," such as "where the change from investment holding to sales activity results from unanticipated, externally induced factors which make impossible the continued pre-existing use of the realty" (Pet. App. A35). But this observation simply recognizes that there may be cases in which the frequency of sales should be discounted because they are a function of forces outside the taxpayer's control rather than of his own making. At all events, the court's statement had no dispositive effect in this case, where petitioner's

¹ *Malat v. Riddell*, 383 U.S. 569, relied upon by petitioner (Pet. 9), does not support its investment motive contention. There, the Court construed the statutory term "primarily" to mean "of first importance" or "principally." That decision deals with the purpose for which the property was held at time of sale, not with the purpose for which it was originally acquired. As explained in the text, the original purpose can change.

decision to convert the land from investment to business use was entirely voluntary.

It is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

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